

**UNITED STATES DEPARTMENT OF AGRICULTURE**  
**BEFORE THE SECRETARY OF AGRICULTURE**

**IN RE:**

**PACIFIC NORTHWEST AND  
ARIZONA-LAS VEGAS  
MARKETING AREAS**

**DOCKET NO. A0-368-832,  
A0-271-837, DA-03-04**

**TESTIMONY OF HEIN HETTINGA**

My name is Hein Hettinga, and I am the founder and co-owner (with my wife) of Sarah Farms. Sarah Farms is named after my daughter and is a family company which was founded about ten years ago. I have been dairying about thirty years. Along with my two sons, I run the operation and my daughter Sarah serves as the comptroller.

Sarah Farms believes that the real purpose of this hearing is to eliminate Sarah Farms from the marketplace. The imposition of a cap would restrict the future growth of Sarah Farms, whatever that may be. Meanwhile, other farmers, other cooperatives, and other handlers would retain the ability to expand without any such restriction. Furthermore, the imposition of any cap based on what marketing conditions might be in the future is unjustified and speculative. The imposition of the proposed three million pound per month cap, which is lower than the current monthly production of Sarah Farms, would force Sarah Farms to examine whether to continue as a producer, whether to continue as a handler, or whether it will be feasible to continue operations at all. These proposals would dramatically injure or terminate our business. This is true even though there is no real evidence that Sarah Farms holds an unfair advantage as a producer or a processor. In fact, the evidence establishes that in exchange for regulation as a producer-handler, Sarah Farms bears costs that are not usually borne by other market participants.

I have been in a number of agricultural businesses throughout my life. I owned a hoof-trimming business and a cattle-trading operation before I began dairying some thirty years ago. About eight years ago, a new state of the art processing plant was built in Yuma, Arizona. The original intent of the plant was to process milk and sell that milk into Mexico. In reality, the primary sales of Sarah Farms occur within the borders of the State of Arizona and the Mexico market represents a small percentage of the company's business. The customers of Sarah Farms include Bashas', specifically its Food City Stores, as well as Sam's Club, Costco and some smaller, independent retailers. Within the first year or so of the operation of the integrated dairy and milk processing operations, Sarah Farms welcomed Food City as its first major customer. When Bashas' purchased the Food City Stores and began to expand its operations, the sales of Sarah Farms began to grow. Sarah Farms currently produces in excess of three million pounds of milk per month and the business would suffer substantially if any of the current proposals (or revised proposals) were to be adopted.

Since 1995, Sarah Farms has operated as a producer-handler in Order 131 without creating disruptive or "disorderly" marketing conditions, and there is no evidence that any disruptive marketing conditions (however defined) are now occurring. Instead, Sarah Farms has consistently operated its business under the guidelines that the United States Department of Agriculture ("Department") has left virtually unchanged and that Congress has consistently protected for decades.

Sarah Farms has been able to successfully operate by controlling the source of its milk and by providing a quality product and good service to its customers. For example, although more expensive to produce, Sarah Farms uses a tamper-proof cap with a foil seal which prevents leaks and air contamination as well as increasing consumer safety. Sarah Farms delivers milk

from its cows to the customer's store within 24 hours which provides for a 17-day shelf life on delivery as opposed to the 10-day shelf life offered by others. In addition, as part of the services provided to several of its major customers, Sarah Farms ships its gallon milk containers in cardboard boxes. As far as I know, no other distributors in the marketing area have been willing to provide this service to their customers. The use of the cardboard boxes insulates the milk from light and also keeps the milk cooler. These examples of quality issues exemplify the type of services provided by Sarah Farms to its customers.

As noted above, Sarah Farms operates as a producer-handler within the current federal regulations, has made a substantial and continuing financial investment and has also built its operations to ensure continued compliance with the current rules and regulations. Over the years, Sarah Farms has been presented with numerous challenges to its status as a producer-handler. For example, the Department received comments from the industry during the course of federal order reform that suggested the curtailment or elimination of the producer-handler exemption. The Secretary properly concluded that:

It has been a long-standing policy to exempt from full regulation many of those entities that operate as both a producer and a handler. ... A primary basis for exempting producer-handlers from the pricing and pooling provisions of a milk order is that these entities are customarily small businesses that operate in a self-sufficient manner. Also, during the history of producer-handler exemption from full regulation there has been no demonstration that such entities have an advantage as either producers or handlers so long as they are responsible for balancing their fluid milk needs and cannot transfer balancing costs, including the cost of disposing of reserve milk supplies, to other market participants.

64 Fed. Reg. 16135 (April 2, 1999).

The Secretary also discussed the small changes that were made to producer-handler regulations for the sole purpose of standardizing the consolidated orders. Importantly, the Secretary noted that, "no changes have been made that would intentionally regulate a producer-

handler that is currently exempt from regulation under current operating procedures.” *Id.* The Secretary also took note of Congress’s unwavering support of the producer-handler exemption.

From the inception of its operation as a producer-handler, Sarah Farms has faced a number of challenges from some of the proponents of the current proposals, including the United Dairymen of Arizona (“UDA”) and Shamrock Foods Company (“Shamrock”). From the time that Sarah Farms was established as a producer-handler in the 131 Market, both UDA and Shamrock have continuously attempted to have the Department disqualify Sarah Farms as a producer-handler.

Both UDA and Shamrock filed litigation in the United States District Court for the District of Arizona in an attempt to contest a decision by the Department that Sarah Farms qualified for the producer-handler exemption. As I understand it, the United States District Court dismissed the action for lack of subject matter jurisdiction and the Ninth Circuit Court of Appeals held that the dismissal for lack of subject matter jurisdiction was correct. See United Dairymen of Arizona; Shamrock Farms Company v. Ann M. Veneman, United States Department of Agriculture, 279 F.3d 1160 (9<sup>th</sup> Cir. 2002).

Sarah Farms is now faced with yet another challenge to its continued existence from UDA, Shamrock and some of the major cooperatives and publicly traded companies in the dairy industry. Large grocery chains and dairy retailers – including Dean Foods and Kroger – are supporting the proposed changes to the Department’s milk marketing orders that regulate Class I fluid milk and are seeking to impose regulatory restrictions on independent producer-handler dairy farms to require those producer-handlers, including Sarah Farms, to set minimum prices for fluid milk. Despite no significant change in marketing conditions since order reform, and without any substantive evidence of disorderly marketing, the proponents seek to effectively shut

our doors. The proposals, if adopted, would force Sarah Farms to change the way it operates, and Sarah Farms would incur increased costs. Depending on market conditions, if the proposals were adopted, the ability of Sarah Farms to continue its operations will need to be examined.

The impact of the various proposals would force Sarah Farms to incur additional costs in the form of Class I settlement fund contributions from which it is now exempted. However, the proponents own testimony establishes no basis for this dramatic change in policy. Instead, the reality is that being a producer-handler involves a substantial amount of risk that the typical dairy farmer does not bear and the “unfair advantage” claimed by the proponents is a fallacy. If being a producer-handler was the fast-track to wealth that the proponents claim, then why aren’t there more of them in this market and in the other parts of the United States? The number of producer-handlers in the Class 131 marketing area has declined from six in 1980 to just two in the year 2002. Moreover, it appears that in the Class 131 Marketing Order has the least number of producer-handlers in the entire country.

For the reasons cited by the Secretary in support of the last decision on this topic, the Department should not adopt these proposals. The regulation of producer-handlers contradicts not only Congress’s stated intent that the producer-handler exemption be preserved, but would also constitute a change in the long-standing policy of the Department. The proponents seek to close our business despite the fact that Sarah Farms bears all of its balancing costs, is entirely self-sufficient, and is a small business under the provisions of the Regulatory Flexibility Act as a dairy products manufacturer that employs less than 500 employees. Moreover, the growth of our production in recent years has been due to increased efficiencies and the growth of our customers.

As noted above, the growth of Sarah Farms is reflected in the growth of its main customers. In this regard, over the last five years there has been a significant shift in the retail industry from small operations to larger warehouse stores and/or larger supermarkets. As previously mentioned, some of the major customers of Sarah Farms are Bashas'/Food City, Costco, and Sam's Club. Each of these customers has grown in the last five years. With regard to Food City, Sarah Farms has gone from serving a small number of stores to serving a substantially larger number. Moreover, discount retail outlets such as Costco are challenging traditional milk processors and grocery chains. The large national cooperatives, dairy processors and food retailers are attempting through these proposals to limit competition which would ultimately impact the consumer both in the quality of the milk that will be available in the market and in the increased price of the milk.

Sarah Farms relies principally on the sale of fluid milk in gallons, half gallons and quarts. Indeed, most of Sarah Farms' sales are from the sale of fluid milk in these size containers. Sarah Farms also has a limited number of sales in sour cream. Sarah Farms has chosen to integrate both its dairy and milk processing operation and to concentrate on the sale of fluid milk. Sarah Farms expended significant capital in reliance upon the exemption from regulation as a producer-handler. Sarah Farms expended substantial capital and took the risk of building a fresh, modern processing plant with the latest equipment and technology. Based upon the technology and equipment that is available today, Sarah Farms is able to utilize these efficiencies to process milk in a more efficient manner, and I believe less expensive than our competition. Moreover, since Sarah Farms focuses on just one product – fluid milk – rather than having to run a plant producing certain items at certain times and others at other times, Sarah Farms can run its plant

consistently and without any significant down time. These savings in processing costs can be passed on to Sarah Farms' customers and ultimately to the consumer.

The proponents suggest that our operation threatens their ability to market milk in the 131 Order area and that Sarah Farms is somehow a threat to their business. These claims are made despite the fact that those testifying in support of the regulations are all significantly larger than our operation. Indeed, Sarah Farms does not have a price advantage over regulated handlers, and these proposals, if adopted, will place us at a distinct price disadvantage.

As noted in the compilation of statistical material for Federal Milk Marketing Order No. 131, the Arizona-Las Vegas Marketing area prepared by the United States Department of Agriculture, Agricultural Marketing Service Dairy Program, there are four handlers operating pool plants within the marketing area. Kroger Company, Safeway Stores, Inc. and Shamrock Foods Company operate distributing plants. United Dairymen of Arizona has a co-op pool manufacturing plant. In addition, handlers operating partially regulated distributing plants in the area of this Federal Order include Dean Foods of California, Inc., Morningstar Foods, Inc., General Mills, and Alta Dena Certified Dairy. I believe that Sarah Farms is smaller than each of the non-exempt plants in the State of Arizona. The August 2003 edition of Dairy Foods, in an article entitled, "A Decade of Change...and a Year of Challenges", which has been marked as Exhibit 54, lists the 100 companies with the largest fiscal year sales in the dairy industry on a list entitled the Annual Dairy 100. The Kroger Company Dairy operation is listed as number seven on the top 100; Safeway Dairy Division is number 23 on the list and Shamrock Farms is listed as number 58. While UDA is not listed in the top 100, 18 cooperatives are among the top 100 companies with the largest amount of fiscal year sales in the dairy industry. There is not one producer-handler in the top 100 list.

What this list exemplifies is that the companies that are challenging Sarah Farms and making these proposals are in a much better financial position than Sarah Farms. Therefore, this is really an effort by the larger companies to eliminate competition in Order 131 which, in my opinion, would have the effect of increasing the cost of milk for consumers in the marketing area.

There has been a seismic shift in the last several years in the marketing of milk. Warehouse stores have decided to market milk at a smaller mark-up or profit margin. This is direct competition at both the retail and wholesale level for companies such as Deans, Safeway, Kroger and locally Shamrock. This is a war at the street level to limit competition which the proponents have now brought into this hearing. Indeed, there has also been heightened concern among consumer advocacy groups, federal lawmakers and state attorney general that large national cooperatives, dairy processors and food retailers are attempting to take advantage of declines in raw milk prices but not passing these cost savings on to the consumers. This is the reality and the factual backdrop for the proposed changes in the regulations made by these proponents.

The proponents also testified that Sarah Farms possesses an advantage as a producer-handler that gives us a competitive edge not available to other market participants. First, that advantage simply is not there. Second, even if it were a reality, there are no barriers that prevent a handler from buying a dairy herd or that prevent a dairy farmer from opening a bottling facility. For example, as shown in a recent article from the Progressive Dairyman in November of 2003, a copy of which has been marked as Exhibit 55, Shamrock Farms Dairy has recently built a 10,000 cow milking facility near Stanfield, Arizona. Based upon my experience, the financial investment in this dairy is in the millions of dollars. This amount has increased because I believe

that Shamrock has recently purchased cows and began its operations at this dairy. Given this investment in a dairy production facility, Shamrock Foods could make a business decision to construct a processing plant near the dairy and to then operate as a producer-handler under the terms of the current regulations, if it chose to do so. While I am not privy to the financial information for Shamrock Foods, since it is confidential and privileged, it is apparent that Shamrock has decided that it is in its best economic interest to operate as a regulated handler rather than a producer-handler even though it has now spent substantial amounts of money to construct a state of the art dairy.

One of the proponents of the changes to the regulations is Shamrock Foods Company. As noted in an article titled, "Shamrock Foods: A Family Company With Foresight", a copy of which has been marked as Exhibit 56, Shamrock Foods is the largest dairy in the Southwest and among the largest five privately held Arizona companies. The article indicates that Shamrock has a herd of approximately 7500 cows. However, that was before Shamrock completed its new dairy near Stanfield, Arizona and added at least 3,000 additional cows. In total Shamrock processes 70 million gallons of milk annually.

In June 2001, Shamrock opened an extended shelf life (ESL) plant facility, which gives Shamrock the ability to put 82 days of code life on its products, which in turn, allows in to serve a larger geographic area with its products. Shamrock produces 12, 20, and 32 ounce plastic bottles of white milk and flavored milk in its ESL facility. Sarah Farms cannot compete with Shamrock on a head-to-head basis given the competitive advantage that Shamrock has in the sale of, among others, ESL products. Shamrock also has the size and financial wherewithal to sell its products in Arizona, Colorado, New Mexico, Utah, Nevada, and Texas. Sarah Farms is not here complaining that Shamrock has an unfair competitive advantage, although Shamrock may have a

competitive advantage in many areas, including in Arizona. Obviously, Shamrock has a certain business plan that it continues to follow. Sarah Farms cannot directly compete in the ESL market and has chosen not to do so. Based upon the arguments made by the proponents, Shamrock has an obvious “unfair advantage” over Sarah Farms because of its ESL plant. Nevertheless, Sarah Farms attributes this advantage to the time, effort, and substantial monetary contribution made by Shamrock in order to grow its business throughout the Western states. Likewise, Sarah Farms has made a substantial monetary contribution and time contribution to become a producer-handler. Sarah Farms and the other producer-handlers should not be forced to bear the risk of a change to the rules in the middle of the game.

Moreover, the claims of unfair competition ring hollow because producer-handler status places limits on the types of customers that Sarah Farms can effectively serve. First, Sarah Farms can only serve those customers who require less milk than it can produce. Unlike a pool handler, Sarah Farms cannot purchase more milk to fill the large or growing needs of a customer. Sarah Farms cannot serve customers whose demand for milk is irregular. Indeed, the profitability of Sarah Farms depends on our ability to effectively control our surpluses and its disposition. When a customer has needs that exceed our farm capacity or would upset our ability to balance, we are faced with the choice of losing our producer-handler status or our customer.

The proponents have suggested that payments from producer-handlers into the producer settlement fund are necessary because Sarah Farms, and other like situated producer-handlers, enjoy an unfair advantage because we can acquire our Class I milk for the blend price. This is not accurate. Sarah Farms does not, as is suggested, enjoy an advantage equal to the difference between the Class I price and the blend price. This simplistic calculation does not take into account our cost of production, for instance, which exceeds the blend price.

Repeated allegations have been made about the pricing of our products, which the proponents “determined” by analyzing retail prices of our products at the store. The specifics of our pricing scheme is proprietary information, but I will state that Sarah Farms does not sell its milk for less than the Class I price, plus the cost of processing, packaging, and transportation. We do not undercut the market by selling our product for less than the Class I price. In fact, I was recently asked to price milk for Costco to be delivered to a market outside of Order 131. The estimate I gave was based on the same formula Sarah Farms uses to supply other customers. Sarah Farms did not get the new order; I was told that our price was not competitive—not even close.

At the hearing, the testimony of Carl Herbien that was used to suggest that our prices were unattainable by a regulated handler were based on plants whose product mixes were not disclosed, but were almost certainly more diverse than that of Sarah Farms. My experience has shown that the cost of processing, packaging, and labeling is about the same regardless of the size package that is run. A plant running straight white milk gallons will have a lower overall cost per gallon than will have a plant running a product mix of multiple sizes and SKUs. The composite cost information provided to the Secretary is meaningless as a basis for comparison. Sarah Farms’ cost per white gallon should be no more than the cost of Shamrock. In fact, it should be less.

Mr. Herbein’s study looks only at two percent white gallons. Without knowing what the same store was charging for whole milk or skim milk, it is impossible to know whether or not the stated price for two percent milk represented a markup over the actual cost from the plant or a markup over some blended milk cost to the plant.

Also, the stated period of time is stated to represent January through June 2003, there is nothing stated to indicate the days of the month or the dates of the month these costs were surveyed. This is relevant because the store may be pricing milk based upon prior months' costs or anticipation of the following month. As a dairy processor, butterfat costs me money. A gallon of whole milk costs more than a gallon of reduced fat milk, which costs more than a gallon of skim milk. Sarah Farms prices its products based on the butterfat content. I have noticed that the stores price milk rather uniformly. To the consumer, there isn't much difference between the cost of a gallon of skim milk and a gallon of whole milk, even though the whole milk costs the store more. Also, the figures cited for Mr. Herbein for transportation are highly overstated based on my experience. Finally, pallet costs do not correlate to those for Sarah Farms because we offer a pallet exchange program. The whole purpose is to keep the cost of my product low—and it works.

The balancing costs incurred by producer-handlers are also significant. In addition to the costs of balancing, producer-handlers have expenses in transportation that other producers do not bear. Producer-handlers bear huge amounts of risk in the event that there are problems at their processing facility. A stoppage in production can mean the loss of raw milk that cannot be replaced by a purchase from another farm. Likewise, problems on the farm such as illness are not only a loss to a producer, but can mean the loss of milk to the plant that cannot be replaced. The result can be lost customers. Managing the timing of deliveries to the plant is also critical, or we must incur additional cleaning costs and difficult scheduling.

These demands, in addition to increasing our operating costs, effectively regulate the size of producer-handlers. At the farm level, we are required to carefully maintain the level of our herd. Herd fluctuations pose the risk of causing large pool plant purchases, which would require

us to lose our status or, alternatively, large surpluses which must be disposed of, often at a substantial loss.

With regard to the other portions of the proposals, Sarah Farms firmly believes that limiting milk distribution to cooperatives and milk processors only works to deny wholesale customers meaningful choice. Due to the state of the dairy industry today, there needs to be a third participant in the market in order to foster competition and prevent monopolistic tendencies. Sarah Farms believes the Department should consider the following:

- Dairy Farmers of America is being investigated by the Justice Department for numerous antitrust violations.
- Dean Foods controls more than 20% of the national market and has driven up the prices of milk for consumers in Southern California by buying up competition.
- Most processors began as producer-handlers and grew out of their role as a milk producer.
- Cooperative associations, formerly a method of protecting dairy farmers in the marketplace, are now less focused.
- The exemption of Clark County, Nevada from the federal order system has enabled Dean Foods to establish a plant which will be far more disruptive to the federal order system than any single producer-handler, or producer-handlers in the aggregate. Furthermore, the Dean Foods plant is not limited by the requirement placed on producer handlers to produce and market all of their own milk. Under the UDA/Shamrock proposal, a smaller independent dairyman will be regulated and competing with a large, national company that is not required to be regulated. How is that fair?

Moreover, as stated before, every producer can, under the law, become a producer-handler. Also, every handler can integrate with a producer. The fact that Sarah Farms is the only producer who has chosen to do so in the 131 Order does not mean that our practices are unfair or that the playing field is not the same for all participants. Instead, it reflects that operating as a producer-handler includes inherent risk that others have been unwilling to accept.

In short, the proponents expect Sarah Farms to pay millions of dollars to other producers who have not incurred our investment costs nor have borne any of our risk. By definition, Sarah Farms must be able to produce all the milk it utilizes. The upper floor on the size of any producer-handler's operation is the point at which it can no longer produce enough milk internally to meet the demand for its products. When that point is reached, only then should there be a forced decision as to whether to maintain current levels of sales or abandon the status of a producer-handler. As technologies are developed and economies change, such that producers are able to increase the number of cows that can be milked, producer-handlers are permitted to take advantage of those advancements as all other producers might. The proposals advanced by UDA, Shamrock and other large cooperatives and national companies deny producers-handlers the benefits of those advancements.

It is my understanding from Mr. Albright's testimony that the AMAA was intended to protect dairy farmers from brutal competition that resulted when milk plants could play farm against farm to drive down prices below a sustainable level. Because a producer-handler cannot compete with other producers for the sale of raw milk, it made little sense to regulate producer-handlers. Indeed, if the proposals were to be accepted, this would work to insulate the entire market area from any further competition and require producer settlement fund payments for any milk produced by a handler on his own farms.

Finally, UDA/Shamrock and the other proponents have argued that Sarah Farms has somehow caused disorderly marketing conditions in the Arizona-Las Vegas Order. As stated above, this is not true in fact, nor do any of the statistics cited by any of the proponents hold water when viewed in the context of the producer-handler's historical market presence.

In sum, there was no disruption in the marketplace found during order reform. There have been no changes in the marketing conditions in the marketing area since order reform. There are no facts supporting a finding of disruptive marketing now. Therefore, the proposals should be denied.